BEFORE THE
COMMONWEALTH OF MASSACHUSETTS
DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

D.T.E. 04-115

COMMENTS OF MIRANT CORPORATION REGARDING PROCUREMENT OF DEFAULT SERVICE POWER SUPPLY FOR RESIDENTIAL AND SMALL COMMERCIAL INDUSTRIAL CUSTOMERS

Introduction

Mirant Corporation and it's subsidiaries, Mirant New England, LLC, Mirant Kendall, LLC, and Mirant Canal, LLC (collectively, "Mirant"), are pleased to submit comments to the Massachusetts Department of Telecommunications and Energy ("DTE") in response to its request for same on the procurement of default service power supply for residential and small commercial customers.

Mirant owns and operates generating facilities totaling 1,397 MW in the Commonwealth of Massachusetts. Those facilities are the electric generators at Canal Station (1,109 MW), Kendall Station (276 MW), and the diesels on Martha's Vineyard (12 MW). Mirant has been an active participant in both the wholesale and retail markets in Massachusetts and in New England.

Mirant recognizes the need for default service as the electricity market continues to evolve. Mirant further recognizes that consumers served by default service are entitled to

reliable service at market-based prices. A well-designed default service procurement process will support the move toward competitive retail markets and away from regulated solutions and will encourage consumers to choose competitive retail providers. A key component of default service is the competitive procurement of electric supply.

Generally, Mirant is supportive of the DTE's current requirements for the procurement of default service. The quarterly competitive solicitation for large commercial and industrial customers is appropriate as these customers are more sophisticated and better equipped to manage their energy needs. The semi-annual procurement for small commercial and residential customers is also appropriate in that it provides a periodic market-based electricity price but with greater stability than the more frequent procurement for larger customers. Additionally, because each utility procures default service at different times throughout the year, the process in Massachusetts is appropriate for drawing competitive suppliers who may have power to offer at varying times of the year.

While we are supportive of the procurement mechanism, Mirant has two specific recommendations that could further enhance the competitive environment and bring greater benefits to small commercial and residential customers. The first recommendation relates to creditworthiness standards and financial assurance requirements imposed on suppliers in the competitive procurement process and the second to expanding aggregation programs.

Creditworthiness and Financial Assurance

Currently, each procuring utility sets its own creditworthiness standards and financial assurance requirements. In many cases these standards and requirements are so stringent that many generators located in Massachusetts either a) cannot meet the credit standards and are, therefore, prohibited from participating directly in the competitive process or b) decide that the collateral requirements make it economically infeasible for them to bid. As such, many of the entities that win requests for proposals ("RFPs") for default service today satisfy the applicable credit related requirements but have no assets and must contract with generators to serve the default load. That is, these winners are often middlemen between end-users and generators. Since many generators are effectively restricted to acting as suppliers for the winning bidders, the number of potential bidders is significantly reduced. Ultimately, this decrease in competitive bidders hurts customers.

Other states such as Maryland and New Jersey have developed set creditworthiness standards and commercially reasonable collateral requirements that apply to all procuring utilities and bidders. This is one possible approach to ease the credit disadvantage faced by default service participants. Mirant encourages the DTE to open a separate docket to more closely examine issues related to creditworthiness and financial assurance.

Aggregation Programs

As you are likely familiar, Mirant has supplied the Cape Light Compact Default Service Pilot Program ("Cape Light Program") for the last two and one half years. This program served approximately 60,000 customers on Cape Cod and Martha's Vineyard representing approximately 60 MW of peak electrical load. Aggregation programs such

as the Cape Light Program provide an alternative to default supply for small commercial and residential customers. In essence, they are a free option for small customers. These programs are organized solicitations that attract multiple bidders and provide stable pricing over the duration of the contract for those who choose to participate; yet participating customers have the option to leave at any time.

At this juncture, the process for establishing municipal aggregation programs is somewhat complex. It took the Cape Light Compact a great deal of time and effort to establish its program and conduct its first solicitation. Mirant recommends the DTE work with the legislature and the Division of Energy Resources ("DOER") to evaluate and streamline procedures to encourage the formation of additional aggregation programs in the Commonwealth.

Response to Request for Comments

The following are Mirant's responses to the specific questions raised by the DTE.

1. **Would smaller customers be better served if power supply for default service is procured using a portfolio of more than two solicitations? Please discuss the advantages and disadvantages of increasing the number of solicitations used to procure default service supply.**

2. **Would smaller customers be better served if power supply for default service was procured for a term longer than twelve months? Please discuss the advantages and disadvantages of using supply terms greater than twelve months.**

   In particular, please discuss:
   a. whether longer contract terms are likely to produce lower prices,
   b. how such an approach would affect price certainty and market efficiency, and
   c. how such an approach could be tailored to accommodate customer migration to competitive supply.

Mirant believes that the frequency of solicitations and duration of the contract are closely linked. If the contract term is shorter it is likely to require more frequent solicitations and vice-versa. Accordingly we will respond jointly to questions 1 and 2.

Mirant supports the DTE's current requirements for two solicitations per year for smaller customers, procuring for 50 percent of the load for a one year contract in each solicitation. If the number of solicitations were to increase and the duration of each contract were to decrease, it could create highly volatile power prices that are representative of shorter term swings in the wholesale power market. Rates would change frequently for consumers, likely causing confusion and making it difficult for smaller customers to budget for monthly electric bills.

Although subjecting customers to more volatile prices would encourage retailers, who can offer more stable pricing for longer durations (e.g., 1 to 2 year contracts), to enter the marketplace (as is occurring for larger customers), there is no guarantee that such retail competition would materialize for small customers. High customer acquisition costs would likely impede the entrance of more retail suppliers.

As mentioned previously, municipal aggregation programs are well positioned to offer smaller customers an alternative to utility default supply in that such high customer acquisition costs are reduced by the advancement and formation of aggregation programs.

Conversely, solicitations that are less frequent than 2 per year and have longer contract terms naturally bring about more stable pricing. This can be beneficial to customers if the forward prices are low, but can be detrimental if forward prices that customers are locked into are high.

When long term forward prices are high suppliers also face risk; namely, migration risk. Assuming that no switching restrictions exist for small customers, they can leave default service when default service prices are high but market prices are low. Suppliers who have bid to serve default load are suddenly left with a partially unhedged portfolio if/when that load migrates to other retailer suppliers. To protect against this risk, suppliers include a migration premium in their bids, which further increases the price to consumers.

Because of the arguments detailed above, Mirant supports the current solicitation process for smaller customers. This balances the need to provide relatively stable pricing with the need to approximate market prices.

Specifically:

a. Are longer contract terms likely to produce lower prices?

As noted above, longer contract terms can bring about more stable pricing, but are not guaranteed to bring about lower prices. Regulatory uncertainty (changing market rules and regulations) at the wholesale level may cause providers to add premiums to their bids. Additionally, migration risk is greater over the course of a longer term contract,

which could cause higher migration risk premiums. Finally, changes in fundamentals such as fuel price make it impossible to guarantee prices will be lower simply because the contract is for a longer duration.

b. How would supply terms of greater than twelve months affect price certainty and market efficiency?

Price certainty would undoubtedly be greater with longer term contracts. Market efficiency, however, could suffer. As mentioned previously, if the price of power under a longer term contract is high you could see "churn" as customers move back and forth between default service and retail suppliers. Longer term contracts can also lead to "step" problems if market fundamentals change drastically from one procurement period to the next, potentially resulting in rate shock for consumers. Further, credit requirements for less frequent and/or longer term solicitations can keep many suppliers out of the marketplace.

c. How can procurement for default service be tailored to accommodate customer migration to competitive supply?

If migration of smaller customers to competitive supply remains the goal of policy makers, Mirant believes that this can best be achieved by enhancing and supporting municipal aggregation programs, as discussed in other sections of our response. Contract terms of longer than twelve months only encourage customer switching when the resulting default supply price is high.

3. **Would smaller customers be better served if power supply for default service was procured on a statewide basis? Please discuss the advantages and disadvantages of using a statewide approach to default service procurement.**

Mirant supports the current staggered method for procurement as it acts to draws competitors to the marketplace throughout the year. This feature would be lost unless the statewide procurement also had a staggered procurement process. If a statewide procurement were enacted, the DTE would need to consider how best to divide customers into blocks, zones, customer classes, etc. All residents throughout the state should not receive the same, socialized price, as this would distort price signals.

4. **Would smaller customers be better served if power supply for default service was procured using an auction process (e.g., descending clock) rather than through requests for proposals? Please discuss the advantages and disadvantages of using an auction process to procure default service. In particular, please discuss whether using an auction is likely to produce lower default service prices.**

The descending clock auction does promote transparent pricing and tends to put a downward pressure on prices. In New Jersey, for example, prices have remained relatively steady over the last 3 years, even as fuel prices have increased. For the one year solicitation, rates increased on average across all utilities by less than 7% between 2002 and 2004. The effect of this, however, is very minimal switching at the small customer level. As of September 2004, less than 0.1 percent of residential customers in New Jersey have switched suppliers.

In Maryland, where they use a statewide RFP process, recent prices have been much higher. As of the April 2004 Standard Offer Solicitation, Pepco customers saw approximately a 26 percent increase in the power supply portion of their bill while

Conectiv Power's customers saw power supply rates increase approximately 19 percent. But it is too soon to know what effect this will have on customer switching. As of November 2004, Maryland still only had 2.3% of residential customers and 3.7% of small commercial and industrial customers served by competitive suppliers.

5. Although the term "default service" is statutory, G.L. c. 164, § 1, it has confused some customers because of its unintended suggestion of nonfeasance in performing a legal or contractual obligation. Is there some better or more descriptive term that ought to be used by the distribution companies on and after March 2005?

Mirant suggests the DTE adopt the term "basic service" in the place of "default service."

Conclusion

Mirant is pleased to have the opportunity to provide its views on default service procurement in Massachusetts. We urge the Commission to explore the utilities' practices with regard to creditworthiness and financial assurance and we encourage the Commission to work with the DOER to further the development of aggregation programs such as the Cape Light Compact.

A process, such as what already exists in Massachusetts, can be viewed as an interim step towards complete retail choice. Through this vehicle default prices will be set at a market level. If marketers are able to offer prices and services directly to customers that are superior to the default product, customers will logically make the switch. Over time the load available for aggregation in a default auction could dwindle significantly and retail choice would become the norm.

Mirant looks forward to an ongoing dialogue with the Commission on these and other issues.

Respectfully submitted,

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